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EPD 1872-60
21 October 1960

MEMORANDUM FOR : The Comptroller

THROUGH : Acting Chief, Development Projects Division
Deputy Director (Plans) *13/RMB* *SWB*

SUBJECT : Audit of EPD-ED/P Activities 1 March 1959 through 29 February 1960

REFERENCE :

- A. Memorandum to Comptroller, EPD-ED/P from Acting Chief, Audit Staff, Subject: "Validity of Unliquidated Obligations in Excess of Contractual Commitments", Dated 27 July 1960
- B. Memorandum for Acting Chief, Audit Staff from Comptroller, EPD-ED/P, Subject: "Validity of Obligations FY-'58, FY-'59", Dated 28 July 1960
- C. Memorandum for Acting Chief, EPD from Chief, Audit Staff, Subject: "Audit of Fiscal Years 1958, 1959 and 1960 Unliquidated Obligations as of 30 June 1960", Dated 3 October 1960

1. Reference C, above, has prompted me to set forth some of the background which may be useful in a better understanding of why this Division has employed the process now at issue with the Chief, Audit Staff. As you personally are aware, Development Projects Division, and before it the group known as Project CHALICE (EPD/ECI), is for the most part wholly engaged in what might best be called "applied research and development" in the field of scientific intelligence collection devices and equipments. In most of these undertakings, we are asking the industrial contractors to expand existing state-of-the-art frontiers far beyond the point where they can rely upon established cost experience criteria.

2. Most of these contracts carry with them conditions of sensitivity such that the contractor is required to set up a special group to handle

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all phases of the assigned work. Even though contracts are carefully managed, we have experienced cost overruns that were not brought to light until after the close of the fiscal period within which the scope of work was clearly established. In the case of a CPFF contract, we have no alternative but to pay these costs. In the instance of price redeterminable contracts, we have consistently felt that the Agency was under some obligation to reimburse for added costs, when reasonably incurred incident to advancing the frontiers of the art and when consistent with actual or implied government approval.

3. The record in this latter respect has not been unfavorable, for of the contracts settled during 1958 and 1959, savings were realized under forty (totaling \$1,024,865), while only ten required modest additional funding (totaling \$144,930.91). I offer these summary facts simply as background within which to assess the validity of the process we have employed.

4. Paragraph three, Reference C, could have stated that:

a. When originally recorded on the books of Finance Division, obligations were supported in Development Projects Division with authentic documentation in strict conformity with the provisions of law and regulation; c.f., Section 200, Title 31, U. S. Code, and those regulations mentioned in the references attached.

b. Obligations were not reduced in a report to the Finance Division after each contract was settled.

c. Obligations were removed from the obligation column on Development Projects Division Allotment Control Records in order to guard against any further payments to the individual contractor under the terms of the contract. These obligations could have been recorded on another control, but that would have had no material effect on any transaction, since another move (with appropriate notation) would have been required before the saving could have been utilized to cover an overrun during the same fiscal period.

5. The opinion of the Audit Staff, to which they are certainly entitled, is appreciated; however, it is our feeling that these opinions require further substantive review. We are in disagreement with the opinion of the Chief, Audit Staff, possibly because of the problem of locating resources to cover overruns in both mandatory and equitably justifiable cases. This is a problem certainly recognized by the Audit Staff I am sure.

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6. The Audit Staff has recommended that these obligations be cancelled or liquidated, and that procedures for the administration of obligations be modified to provide for the cancellation of unliquidated obligations upon the completion of contracts. This, I submit we do immediately upon settlement of a contract, albeit only within Development Projects Division. If the Chief, Audit Staff would be willing to reverse the order of his recommendation, establishing a better coordinated procedure prior to effecting any liquidations in the official obligational position of the Agency, I am sure we would find ourselves in accord with such a position. This is based on the fact that if it is contrary to law to establish an obligation for a single-year appropriation after 30 June of the fiscal year in which the appropriation was granted, it would appear improper to record a liquidation and then reinstate all or any portion of the amount removed from obligational status after the close of the fiscal year in which the funds are appropriated.

7. Additionally, the Audit Staff was orally advised that we have been faced with one contract (BQ-1806) where an overrun exists in the rounded amount of \$1,000,000. If it seems dictated, we could conceivably be expected to expense all savings realized to date, and it may be possible that counsel would rule this a correct action under paragraph (a) (6) of the legislation previously mentioned.

8. With the feeling that some time and additional discussions may be required to finally resolve the question raised by Chief, Audit Staff, and to provide a mutually agreed solution to the problem of these overruns with which we are confronted, I am taking the liberty of attaching, as Tab A, a proposed paper for your consideration as an interim measure.

WFD

Assistant Chief
WFD-ED/P

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Attachments

- A. Tab A
- B. References A,E,C

10/27/60 -
Orig. & attachments
to TAF for comment
per WAF

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